Business Finance - Assignment 2

Q1] Liquidity preference refers to investors preferring cash now than on a future date, hence to compensate for this interest is paid.
Example: Investors demand higher interest on long term bonds than on short term loans due to liquidity preference.

Q2] Listing on stock exchange will adversely affect dividend policy, as to prior dividend the company might need to readjust policy as per industry standards and investors ~~per~~ perception of the companies risk. It will need to revise and be stable with the investment policy then.
Conflict of interest between stockholders and

~~the~~ lenders might affect risk management. As lenders would prefer no additional risk whereas stockholders prefer higher gearing due to benefits of debt capital over equity. Also managers might not want to increase risk as it affects their job security compared to equity holders.

Q3] Dividend policy is influenced by the industry standard in which company operates. Their cash reserve also affects the directors desire to announce higher dividends. Stock market reacts readily to change in dividend policy hence they would taken into consideration. The stage at which company operates, example if its in the growth stage it would prefer reinvesting most of the profits. Also the dividend policy should be stable and consistent which would greatly affect the dividend policy. Also if majority ~~to~~ shareholders are non-taxpayers they would prefer higher or consitent dividend compared to others.

Q4) Soletrader,

Ownership : Only one person owns and operates the entire entity. He can hire employees to work under him.

Liability : They have unlimited liability, hence if business is unable to pay all debt owner's personal asset will be used.

Legal status : There is no separate identity. No need for special documents or incorporation.

Partnership,

Ownership : Owned by two or more people, who own the business together they are called partners.

Liability : Each partner is jointly, severally liable and has unlimited liability.

Legal status : The partnership has no separate legal identity. It is governed by partnership agreement.

Limited Company,

Ownership : Owned by shareholders. ~~who~~

~~so~~ Liability : Each and every shareholders has limited liability to amount of capital invested in the company.

Legal status : A limited company has separate legal identity from its owners and needs to be incorporated.

LLP

Ownership : It is owned by members who work and manage company together.

Liability : Unlike partnership, each and every member has limited liability to the amount invested.

Legal status : LLP has separate legal identity from ~~of~~ the members.

Q5] He ~~should~~ should opt for sole trader as he would be taxed only once on the profit due to no separate legal identity whereas limited company, he'll have to pay corporation tax and an income tax on profit which gives as dividend due to the separate legal identity.

Q6] M and M theory of states that a companies capital structure is irrelevant to the market price of the company. They argue market price is derived from the investing decision rather than financing decision

Q7] Working capital is the difference between the current asset and current liability of the company. It is the amount of money used to cover the day-to-day running of business.
Whereas fixed capital includes fixed asset ~~and~~ such as land building, machinery which are used directly in profit making activity.

Q8] Economies of scale is when the average cost per unit, or overall cost falls due to mass production or operations on large scale. This is because the fixed cost gets divided over more units. And larger organizations are able to have cheaper loans, earn higher revenue and be able to manage a risk and adverse conditions better.

Q9] The consequence of pension fund reporting annually is that they have to make sure to invest in less ~~volat~~ volatile and riskier asset than they would have if reporting was done semi-annually as then the managers would have less pressure of ~~to~~ showing decent performance as there will be less than regular checks.

Q10] Scenario 2 as I wouldn't have to go through the emotional rollercoaster of loosing money and worrying about it to finding it. Also money could have been designated for something loosing which would have meant I would have to finance it from somewhere else for that period of time

Q11] Holding buffer inventory means you have some money always tied up in it. which means that there is opportunity cost in holding it. Also there will be other cost like insurance and storing that too will be incurred.